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As I See

THE PROBABLE EFFECTIVENESS OF EASY MONEY IN INCREASING REAL ESTATE ACTIVITY

THE typical real estate pattern which we have followed in the past in the United States would indicate that the readjustment which started a year ago will last for a period of years. Since 1795 we have never had a real estate readjustment which lasted less than 6½ years. This is shown on the long chart showing real estate activity cycles at the bottom of the following pages.

Undoubtedly one of the reasons why these periods of real estate inactivity were long was that real estate financing was not available on favorable terms during the period of the readjustment. The monthly pay-off loan in past periods was the exception rather than the rule, and many mortgage loans coming due in those periods could not be refinanced.

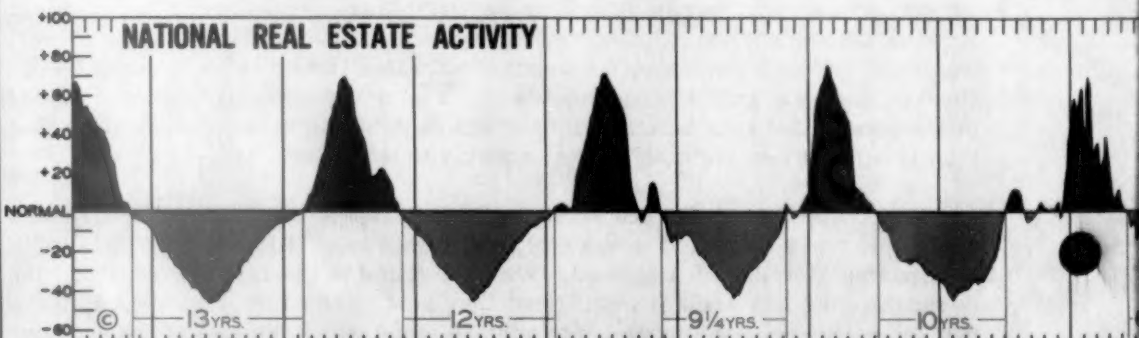
In 1933 in the United States we embarked on a new type of economy. The Federal Government, which, according to the concepts of the Constitution, was to be a federating and coordinating agency, started assuming the responsibility for the welfare of the citizens of the various States. The development of the Welfare State culminated in legislation in 1946 making depressions illegal in the United States.

In previous depressions the United States was on the gold standard, with the exception of a short period following the Civil War. This tended to retard the rapidity with which the value of our money deteriorated. Since 1933, however, we have been on a gold-plated standard, or sometimes I think it might be defined better as a gold-washed standard. The unexpressed philosophy behind this has been that it is better to inflate and destroy the value of our money than it is to allow a readjustment in the economy to take place.

We have assumed that the amount of money which the Federal Government could spend was unlimited in quantity, and if we couldn't find enough uses for it at home we distributed it abroad. We have found in the last few days that the friendships we buy are not worth what they cost, and eventually we may learn that the economic stability we try to achieve is not worth the loss of the accumulated savings and capital of the American people.

Certainly in the recent past many steps have been taken to halt the recession, and in the real estate field to increase the volume of building and the number of transfers. Interest rates on short-term Governments have shown the sharpest drop in history, as the Federal Reserve has taken definite action to ease money and credit. All financial institutions are being forced into the position where they cannot pay interest on their savings deposits unless they enter vigorously into the market in making loans which many of them a few months ago would have questioned as to soundness. In addition, the Federal National Mortgage Association (Fannie Mae) has been authorized to make commitments to buy at par up to $1 billion worth of low-cost home mortgages insured by the Government. Although Eisenhower signed this bill, he criticized it severely as an unnecessary drain on the Federal Treasury. Fannie Mae is a Government attempt to provide a market for insured mortgages regardless of the supply and demand situation, just as the agricultural program provides a market for agricultural surpluses whether they are needed or not. I sincerely hope that this attempt to circumvent the law of supply and demand on mortgage funds will not result in the same type of insoluble confusion which has resulted from our agricultural adjustment program.

The State of New York has passed legislation, signed on April 24 by Governor Harriman, allowing savings banks and State-chartered savings and loan associations to make 90% loans on owner-occupied one-family housing, not more than two years old. These loans can run for 30 years for as much as $25,000, but can be made only within New York State and within 50 miles of the institution's head office. This is far more favorable to the borrower than the provisions previously in force. A $27,777 home, under these provisions, could be purchased with a downpayment of $2,777, and the mortgage of $25,000 could be made by a bank or a State-chartered savings and loan association. This would be a conventional uninsured mortgage. The same terms on the FHA-insured mortgage would require a downpayment of $7,777, with a maximum of $20,000 on the mortgage. It seems to me that the risk to the lending institution, should it make the full percentage loan, is considerable in contrast with the almost negligible risk on the FHA-insured mortgage with the far larger downpayment.



Undoubtedly the ease of credit which is Government inspired will cause some marginal building to go forward. Whether it will build inventories of new unsold houses, only the future can determine. If the major difficulty in the residential construction field is the tightness of credit, certainly the easing which has taken place should provide a really large volume of residential building this year.

I suspect, however, that the credit difficulty is not the sole difficulty, and that the spurt we are seeing in new building at the present time is to some extent anticipatory building which may or may not move readily into the hands of the ultimate consumer. If building goes forward faster than sales can be made, it will be but a limited time until the volume of building will drop, regardless of financing.

If ease of credit can solve the real estate readjustment period, we should expect real estate activity to rise consistently during the remainder of 1958, bringing it back above our normal line some time later in the year. There are many reasons for believing that this may happen. Certainly it will be strange if the very loose credit now available does not increase the number of sales, not only of new buildings, but of older buildings coming on the market. If this happens, however, it will be the first time in more than 150 years of real estate activity when a real estate boom was followed by a readjustment period this short.

I am watching transfer figures very carefully in all the principal cities of the United States. So far the pattern we have developed since we went below our normal line a year ago has been typical of the beginnings of readjustment periods in the past. Even though real estate activity should increase during the next year or even two years, it might still be the beginning of a pattern somewhat similar in shape to the readjustment period which started in 1893. A study of the chart will show that real estate activity dropped rapidly and then moved upward during the latter part of 1894 and during much of 1895, followed by a downward movement again in 1896. Economic trends rarely run in one direction without interruption from time to time. It is sometimes difficult to determine whether the

movement at a particular time is a short-term fluctuation or a long-term trend. The current figures and the arguments based on the ease of financing at the present time would seem to indicate that the worst of the readjustment is over. Our long-term charts would make this conclusion doubtful.

At the present time I am in a condition of suspended judgment. I do not know how effective some of the current attempts to change this cycle may be. I am sold on one factor, however, and that can be summarized in the general idea that a Welfare State and a law against depressions are rather highly inflationary, and that over a long period of years our money will decrease in value with a corresponding increase in the dollar value of tangibles. This, of course, is the one thing that gives profits to the real estate speculator. I still believe that for the next few years there is a considerable chance that the selling price of real estate may decline, but I am equally confident that in the longer period, real estate will sell for a higher price than that for which it is currently offered.

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